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**Public Bus Transport in Germany: A Proposal to Improve the Current
Awarding System**

– DISCUSSION PAPER –

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Berlin, April 2011

I. Introduction

Introducing competition in the German market for short-distance public bus transport services has brought successes, but also some notable failures. Following the international trend towards liberalization in the mid-1990s, German legislators implemented a specific framework for awarding contracts structured around two parallel license types within a single market: (i) non-commercial licenses (*gemeinwirtschaftliche Genehmigung*, see § 13a PBefG) and (ii) commercial licenses (*eigenwirtschaftliche Genehmigung*, see § 13 PBefG). In practice, both types provide exclusivity for the licensee.

However, the resulting complexity of the system is a reason why many researchers, as well as global players trying to enter the public transport market, often describe the regulatory framework as initially incomprehensible. The many different failures and pitfalls of the specific German model analyzed by Beck (2009a and 2010a) raise doubts about the feasibility and user friendliness of this system. Nevertheless the great variety of opportunities for action for authorities and operators remains a major advantage.

An evaluation of international efforts to introduce competition to public transport service markets (see van de Velde and Beck 2010) shows numerous different models and attempts to regulate the functioning of these markets. In Europe, a change of mind, or a possible trend, towards more market-based regimes can be observed in recent years. There will also be some effect of the new legislation at the EU-level, the European regulation (EC) No. 1370/2007 (hereafter referred to as EC 1370) on the awarding of public service contracts for public transport services that took effect on December 3, 2009.

The issue for Germany now is whether a viable alternative to the current model of contract awarding could enhance the regulatory framework. Considering current discussion about the amendment of the German Passenger Transport Act (*Novelle des Personenbeförderungsgesetzes – PBefG*), the aim of this article is to present an attempt to clarify the regulatory framework for short-distance public transport services in Germany. Based on the main options possible according to EC 1370, my model incorporates the insights of my doctoral thesis, which examines the market for commercial and non-commercial services, see also Beck 2009a, 2009b, 2010a and 2010b. Moreover, the model is based on discussions with many transport experts, notably my former colleagues at BSL Management Consultants (Julia Ahrend, Caroline von Kretschmann, Mathias Lahrman, Mirko Schnell,

and, in particular, Jörn Meier-Berberich and Marc-Oliver Wille) and attorneys (in particular Sybille Barth and Lorenz Wachinger, BBG and Partner). I extend my thanks to all of my discussion partners for their useful remarks. I am also grateful to Kay Mitusch, my professor at KIT - Karlsruhe Institute for Technology (Section for Network Economics, Institute for Economic Policy Research [IWW]). Nevertheless, the usual disclaimer applies and sole responsibility for the proposed model is assumed by the author.

II. An attempt to adjust Germany's existing institutional framework

Based on the existing institutional framework, its development over time and the market developments for commercial and for non-commercial services discussed in my doctoral thesis, I conclude that:

- the German dichotomy between commercial and non-commercial services provides a greater variety of options for operators and PTAs (Public Transport Authorities [Aufgabenträger]) than in other parts of the world
- the German system is still characterized by a significant market share of direct awarding, making a fundamental change unrealistic in view of the intense debate about cases where competition has been introduced
- still, there is ample room for improvements, as the existing framework prevents more dynamic market developments due to the many structural obstacles that increase uncertainty for market participants.

Regarding the numerous lawsuits and intense debate among legal professionals throughout the past decade, any proposed model must provide procedural clarity to market participants and ensure more smoothly functioning structures. This holds especially with respect to the high level of uncertainty and numerous pitfalls resulting from the current regulatory framework.

Thus, I propose six objectives for a new model:

Six objectives for an adjusted model for Germany

The new model should

1. be flexible in the range of options to ensure efficient market organizations
2. provide a variety of options for action to operators and PTAs
3. offer possibilities for a high level of freedom to operators to design services
4. provide a framework conducive to innovation
5. contain well-defined regulations for awarding procedures and delegate defined roles and tasks to market participants
6. avoid legal uncertainties due to unambiguous regulations on awarding procedures (transparency)

Below, I discuss how to adjust the existing German framework. The proposal aims to solve several of the problems identified during my research on the present regulations for awarding and contracting. At first glance, the process flow chart in Figure 1 may appear complicated, since the system currently allows several processes for awarding. I preserve this diversity but clarify the decision paths to reduce uncertainty for market participants. The proposal assumes that licenses provide exclusivity during the license term.

The proposal consists of various decision nodes (explained in detail below). At a decision node there are usually several options and a single decision-making party. To facilitate my explanations in the following, the numbering in Figure 1 corresponds to that of the subtitles, i.e. the main steps of the procedure.

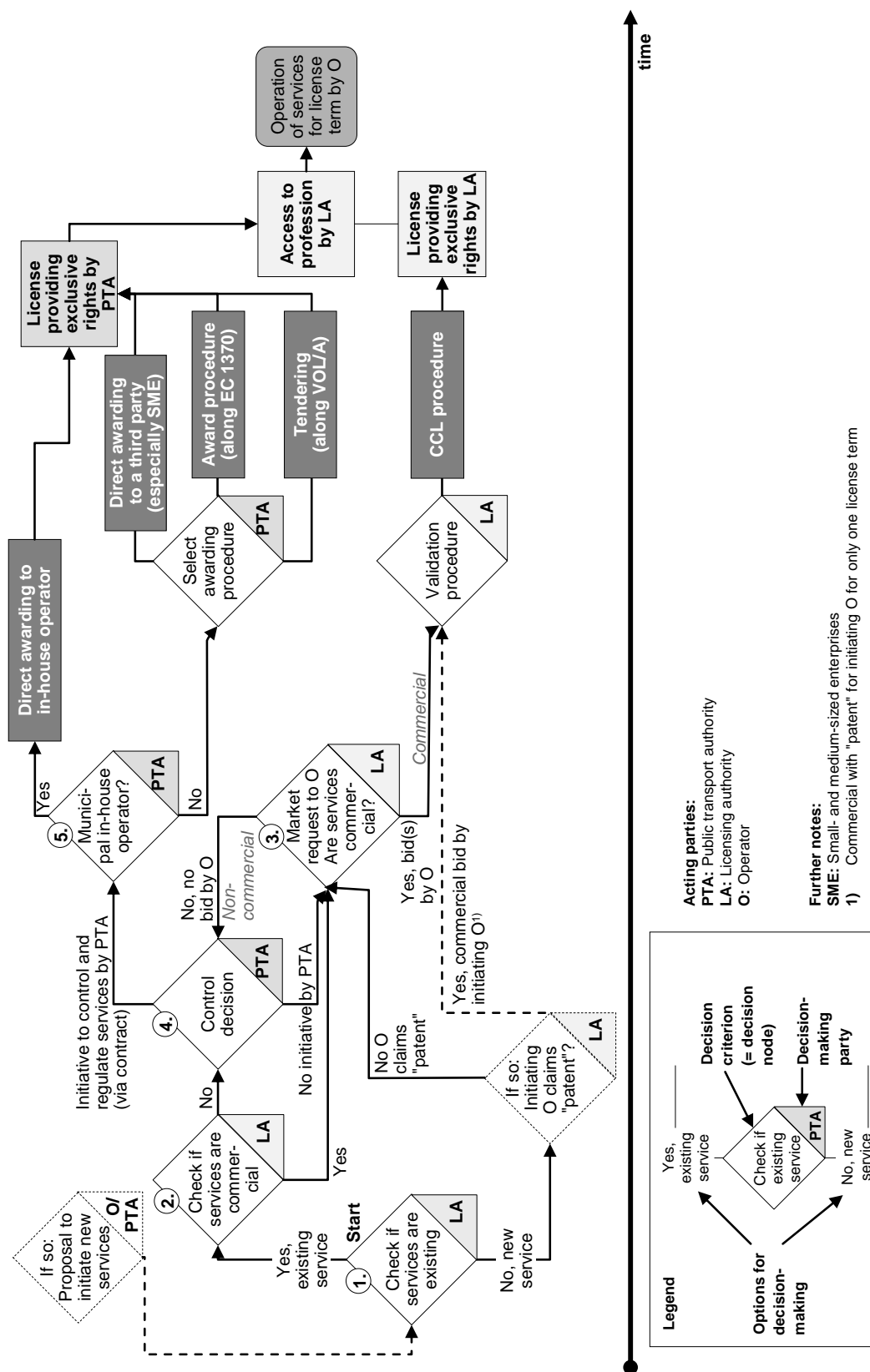


Figure 1: Proposal for an adjusted award model for Germany (decision tree)

Step 1: LA determines whether a proposed service is new

To promote innovations within the system, operators (or PTAs) can propose to provide a new (additional) service at any time. Upon request by the initiating stakeholder, and by involving the PTAs (Public Transport Authorities [Aufgabenträger]), the LA (Licensing Authority [Genehmigungsbehörde]) determines whether a proposed service really is new.

If the service in question is classified as new, the LA checks whether the service is initiated by an operator and whether the operator claims exclusivity for its proposal. If the operator claims exclusivity, it will be the only player allowed to submit a bid to operate the service under a commercial license for the first license term. If the bid fulfills the usual minimum criteria of the LA,¹ the operator is directly awarded the license for one license term. Thus, this license shows similarities to a patent. By offering “patent”-like exclusivity to the operator initiating the process, the proposed model aims to promote innovations as is done in other industries, while recognizing that the number of such cases will be limited. Of course, a “patent” must be handled with care, for example by establishing some minimum criteria for a service to be classified as “new”.

If the service in question is initiated by the PTA, or if the initiating operator does not claim exclusivity for its proposal, the LA proceeds by clarifying whether the service is commercial (i.e. Step 2).

Step 2: LA starts clarification whether existing service is commercial for the next license term

For existing services, the LA publishes the termination date of the license and the validation criteria for a possible CCL procedure (CCL: competition for commercial lines [Genehmigungswettbewerb]) to resolve the problem of unclear or non-existent validation criteria on the part of the LAs, and the confusion about termination dates that still exists in some regions.

¹ The LA is responsible to check compliance with minimum criteria for: security, economic capability and reputation of the operator (e.g., adequate delivery of appropriate service according to previous PTPs) and fulfillment of minimum quality standards for the service set by the PTP.

The LA then verifies whether the service would be considered commercial for the upcoming license term by studying the expression of interest from either the incumbent operator (Altbetreiber) and/or competing operators desiring to provide the service commercially for the next license term. Expressions of interest must be submitted within the time frame set by the LA in advance. Without a time limitation, a competitor could (and did in several cases) disrupt an ongoing awarding procedure by applying for a commercial service.

The PTA always remains responsible for defining the minimum quality level (according to its definition of services of general interest) to be delivered via its PTP (public transport plan [Nahverkehrsplan]). In contrast to the situation today, the PTP is binding for the LA in the first instance, and the PTA is obliged to establish the PTP in a clear and non-discriminatory manner. Nevertheless, operators are still allowed to contribute to the PTP. The PTA can raise or lower the minimum quality level at the outset to reclassify the service in question from commercial to non-commercial and vice versa (see Beck 2009a).

Step 3: For commercial services, LA submits formal market request to operators

If the LA initially classifies the service as commercial based on the expressions of interest by operators as described above, the next step is a formal market request which is based on the binding bids submitted by the operators. In this case, the LA is obliged to avoid intolerable risks by ensuring transparency on relevant revenue data for newcomers (as already observed for several tendering procedures). This will reduce the problem of the winner's curse which arises when an operator's bid overestimates the revenue potential. Such a risk has been identified by numerous empirical studies as a clear market entry barrier for net-cost contracts tendered. Nevertheless, with the aim of providing favorable incentives, operators should bear the full revenue risk. If the LA, upon its formal market request, receives no bids by operators to operate the service commercially, the LA hands the procedure to the PTA which awards supplementary direct subsidies (see Step 4).

If one bid is received, the LA checks whether it satisfies the minimum criteria and then validates it as part of a CCL procedure according to the validation criteria published prior to the formal market request. When more than one bid is received, the LA selects the best bid with respect to quality in a transparent validation procedure (quality competition).

In contrast to the current situation, the procedure does not provide the incumbent (Altbetreiber) with any special privilege. Moreover, the new CCL procedure contains a clear procedural framework similar to tendering procedures in order to avoid lawsuits lasting months (or years) and legal uncertainties for incumbents and newcomers.

Finally, the LA awards a license to operate the service under exclusivity for the license term to the winning bidder in the form of a contract pursuant to EC 1370.

Step 4: PTA makes control decision

If no expression of interest or, finally, no binding bid for a commercial service is submitted, the LA hands the procedure to the PTA which then decides whether or not to control the service directly via a public service contract. If it opts for a public service contract, the PTA will then need to pay the supplementary direct subsidies necessary to satisfy the minimum quality level (see Step 5). For example, numerous experts expect that services currently operated by municipal operators will in reality be non-commercial.

On the other hand, if the PTA does not want to maintain direct control over the service for fiscal or political reasons, it can hand the procedure back to the LA, thereby precluding a costly and time-consuming awarding procedure and the need for subsidy payments, contract controlling and settlement of accounts. The LA then (again) initiates the formal market request to operators as described above. This time, however, the LA permits bids that fail to meet the minimum quality level of the PTP. The LA then identifies the operator offering the best quality on a commercial basis, as described above in Step 3.

Step 5: PTA decides on direct award or a competitive procedure

If the PTA decides to take direct control and wants to pay the supplementary direct subsidies necessary to provide the minimum quality level, the proposed model foresees a decision about whether or not the service will be provided in-house. EC 1370 Art. 5 (2) defines in-house as a provision by “a legally distinct entity over which the competent local authority ... exercises control similar to that exercised over its own departments”, e.g., a municipal operator owned by the PTA. If the service in question will be provided by an in-house operator, competing operators are still free to submit expressions of interest to the PTA (already possible

today). Nonetheless, the PTA is also free to mandate its in-house operator according to EC 1370, e.g., for political reasons.

If no in-house operator is selected, the PTA can choose from the following options:

- a direct award of supplementary direct subsidies
 - to small- and medium-sized enterprises on the condition of Art. 5 (4) EC 1370
 - to other enterprises in small shares on the condition of Art. 5 (4) EC 1370
 - to any operator as an emergency measure on the condition of Art. 5 (5) EC 1370
- a competitive award of supplementary direct subsidies according to Art. 5 (3) EC 1370 (e.g., via negotiations with several operators)
- a formal tender of supplementary direct subsidies under VOL/A which represents a clear, formal and adjudicated framework (and, of course, also satisfies Art. 5 (3) EC 1370).

In any case, the LA checks the usual minimum criteria. Thereafter, the PTA concludes the contract with the preselected operator or the winning bidder, which includes a license that provides exclusivity for the license term.²

III. Conclusion

This article proposes a model to adjust the current awarding framework in Germany. Although there are many international models, a fundamental change seems unrealistic for Germany considering the intense debate about cases in which competition was already introduced. Thus, by using the decision tree illustrated in Figure 1, the proposed model aims to clarify the existing framework by assigning more clearly the roles and tasks of PTAs, LAs and operators within a specified time frame.

The proposed model illustrates that the objectives for adjusting the existing German model are both administratively feasible and realistic. It preserves the dichotomy between commercial and non-commercial services and offers a variety of

² Again, access to the profession of being a bus operator is provided by the LA, here acting as a neutral authority between PTA and operator.

options for action to authorities and operators. Following the principle of subsidiarity promoted at the EU level, local market participants are free to select the procedure that fits their objectives, including the PTA's opportunity to select a municipal operator. The proposed model enables competition of different awarding modes within the market without any clear preference on the part of the legislative body. The number of options is nevertheless reduced in favor of a clear awarding structure, e.g., it does not allow CCL applications that would disrupt an ongoing tendering procedure.

At the same time, the general preferential treatment of market initiatives is one of the main pitfalls of the current system: if operators are licensed to provide commercial services under an excessively low minimum quality set by the PTA in its PTP, e.g., due to false expectations regarding commercial feasibility, the PTA cannot take full control of the service, even if it wants to do so. The dichotomy between two different authorities raises the issue of coordination. I suggest that it would be helpful to maintain a licensing authority on a state level as seen in Lower Saxony. As in New Zealand, the LA could also, upon request, support the PTAs with consultant services on awarding procedures, and assume full responsibility for the awarding if the PTA does not want to become involved.

Although the proposed model avoids any radical changes, the reduced level of overall uncertainty provided for new entrants has the potential to improve market development and reduce the entry barriers resulting from an unclear framework and non-transparent awarding procedures and revenue data. The potential of the incumbent to discriminate in a CCL procedure is mitigated by: (i) publication of the license's termination date (ii) limiting the role of the incumbent in developing the PTP, (iii) abolishing the incumbent's privilege in the CCL validation procedure, and (iv) establishing minimum requirements for providing revenue data. Legal uncertainty can further be reduced by clearly-stated regulations about conducting awarding procedures over time.

If desired by the local authorities, the model allows a high level of freedom to operators and even promotes innovation by offering a "patent"-like exclusivity to innovators. In general, the model allows for competition among ideas between operators and for competition among models for market organizations.

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